IN THE

Supreme Court of the United States

October Term, 1936

No. 330

THE UNITED STATES, *Petitioner*,

v.

AUTOMATIC WASHER COMPANY.

On Writ of Certiorari to the Court of Claims.

BRIEF OF AMICUS CURIAE.

This brief is limited to the contention that, properly construed, the phrase "rights to subscribe for or to receive such shares or certificates" as used in Schedule A, paragraph 3, of the Revenue Act of 1926 means (1) those *rights* of an existing security holder of a corporation to subscribe for *additional* shares of stock in such corporation and, when paid for, to receive such shares, and (2) *rights* of an existing security holder of a corporation *to receive* stock dividends which have been declared.

The undersigned is counsel for Middle States Petroleum Corporation in a suit against the United States pending in the Court of Claims which involves the correct construction and application of the above quoted phrase of the statute,

although the facts in that case are different from the facts in the case at bar.

SUMMARY OF ARGUMENT.

1. The phrase "*rights* to subscribe for or to receive such shares or certificates" is used in the Revenue Act of 1926 (and in the prior Revenue Acts) according to its usual and distinctive meaning in corporation practice, which is its popular, ordinary, commonly accepted meaning—and means (1) *rights* of an existing security holder of a corporation to subscribe for *additional* shares of stock in such corporation and, when paid for, to receive such shares, and (2) rights of an existing security holder of a corporation *to receive* stock dividends which have been declared. The word "*rights*" is similarly used in the statute in its distinctive sense and meaning in corporation practice, and does not mean the plurality of the noun "right" in its broad generic sense, such as an inchoate right, title, or interest for which the government contends. Congress employed those words as above stated, and intended that they be given such meaning.

2. Applicable rules of statutory construction require that the phrase in question be construed according to its usual and distinctive meaning in corporation practice, which is its popular, ordinary, commonly accepted meaning, inasmuch as a different purpose is not indicated. This Court has recognized such distinctive meaning of the word "rights".

I

The Meaning of the Phrase.

When Congress used the words "rights to subscribe for or to receive" with the words "such shares or certificates of stock . . . in any corporation", it is presumed to have used such words in the same category, viz., stock interests in corporations,—not a right in its broad generic sense.

"*Noscitur a sociis*"—it is known by its associates. In corporation practice, and in law, those words have a distinct meaning according to this Court's decision in *Miles* v. *Safe Deposit & Trust Company*, 259 U. S. 247, 252, where it stated that such "right[s] to subscribe" are axiomatic in American corporation law:

> "*The right to subscribe to the new stock* was but a right to participate, in preference to strangers, and on equal terms with other *existing stockholders*, in the privilege of contributing new capital called for by the corporation,—an equity that inheres in stock ownership under such circumstances as a quality inseparable from the capital interest represented by the old stock, *recognized so universally as to have become axiomatic in American corporation law*. Gray v. Portland Bank, 3 Mass. 364, 3 Am. Dec. 156; Atkins v. Albree, 12 Allen, 359, 361; Jones v. Morrison, 31 Minn. 140, 152, 153, 16 N. W. 854; Eidman v. Bowman, 58 Ill. 444, 447, 11 Am. Rep. 90; Humboldt Driving Park Asso. v. Stevens, 34 Neb. 528, 534, 33 Am. St. Rep. 654, 52 N. W. 568; Electric Co. v. Edison Electric Illuminating Co. 200 Pa. 516, 520-523, 526, 50 Atl. 164; Wall v. Utah Copper Co., 70 N. J. Eq. 17, 28, et seq., 62 Atl. 533; Stokes v. Continental Trust Co., 186 N. Y. 285, 12 L. R. A. (N. S.) 969, 78 N. E. 1090, 9 Ann. Cas. 738. Evidently this inherent equity was recognized in the statute and the resolution under which the new stock here in question was offered and issued."

In that decision the Court also spoke of: "ex-*rights*" in referring to values of existing stock after the exercise of "rights" (p. 252); "*right to subscribe* to the new issue was offered to existing stockholders upon the terms mentioned" (p. 251); "the stockholder's *right* to take his part of the *new shares*" (p. 252); "the *subscription right* of itself constituted no gain" (p. 252); "sale of *subscription rights* as represented" (p. 253); "*subscription rights* as an increase inseparable from the old shares" (p. 253); "the *sale of rights* as a sale of a portion of a capital interest" (p. 253); "what would have happened had defendant in

error decided to accept the new shares and pay the issuing price instead of *selling the rights''* (p. 253); ''whether the purchaser exercised his *right to subscribe''* (pp. 253-4).

In that case the question decided was what portion of the proceeds of a sale of the preferential right of existing stockholders to subscribe for shares of a new issue of stock in the same corporation constituted taxable gain, and this Court emphasized the recognition of such rights as axiomatic in American corporation law.

The court judicially knows that in corporation practice and financial circles the word ''rights'' has as significant a meaning as the word ''stock'' or ''bonds''. ''Rights'' are equally as much the subject of ownership as are shares of stock. They are generally evidenced by certificates either in bearer or other transferrable form and issued with or affixed to certificates of stock or bonds of a corporation, or directly to existing security holders, entitling the owner to purchase additional shares at a fixed price in proportion to his present holdings in the corporation, at his option, or to receive stock dividends. They are traded actively on the security exchanges and ''over the counter''. Such is the property—the instruments—referred to by Congress in this statute as ''rights''. This is confirmed by the definitions of lexicographers and eminent textbook and encyclopedia authors, amongst which are:

Funk & Wagnall's New Standard Dictionary (Ed. of 1917), page 2115, defines the word ''right'' as used in finance as follows:

> ''RIGHT, *n.* * * * 7. *Finance.* A stockholder's privilege to purchase *new stock in a corporation at a special* price * * *'' (Italics ours.)

Webster's New International Dictionary, Second Edition G. & C. Merriam Co., 1935, defines the word ''right'' as follows:

> ''right, *n.* * * * 6. *Finance.* A privilege to the stockholders of a corporation to purchase proportionate

amounts of a new issue of securities, generally at par or at a price below that prevailing in the market; also, the negotiable certificate evidencing such privilege. *Frequently pl.* * * * " (Italics ours.)

Fletcher's Cyclopedia Corporations—Permanent Edition (1933)—Volume 19, (Section 8907. *Stock purchase warrants*), page 64, defines the word "rights" in the singular sense as follows:

"A 'right' is the privilege given by a corporation to its stockholders, within a named short period of time, to subscribe to a new, or an increased, issue of stock of the corporation in proportion to the present holdings of such stockholder in the corporation, and is not an incident of the sale of any other securities of the corporation."

And at page 155:

"Sec. 8975. *Offer of right of subscription to present stockholders.* So long as discussion is being had of the various methods of issuing stock of the corporation, it might be well to discuss here the method of financing the capital requirements of a corporation already in existence by increasing the authorized capital stock and offering it for subscription to present stockholders, *although that subject has nothing to do with original issues of stock*, which has been the subject under consideration.

"A successful corporation which desires to expand its operations and, in order to do so, must raise additional capital, will often accomplish this by offering to present stockholders *the right to subscribe to an additional* issue of stock at a price somewhat *below the current market price for the same stock. This offer is first made to the stockholders rather than to the public in general* for one or more of three reasons: * * * "

Conyington's *Corporation Procedure* (Rev. Ed.) p. 827, makes the following observations concerning "rights":

"In the different stock markets there is a different understanding as to what is meant by the word 'right'.

In New York *a right is understood to represent the interest in the new issue which* inheres in each share of old stock. Thus, in the example given, where the right will be to subscribe for one new share for each two shares of old stock held, the owner of one share of old stock will be considered as having one right, even though it be only to subscribe for one-half share of new stock, and the owner of ten shares will possess ten *rights*. In Philadelphia, however, and possibly in other markets, the word 'right' is considered as applicable to the new stock to be received. The owner of two shares of old stock would have one right and the owner of ten shares would have five *rights*."

Conyington-Bennett-Pinkerton on *Corporation Procedure* (5th printing 1924) describes the usage of the word as follows:

"Sec. 241. *The 'Stock Right'.* When a corporation desires to obtain capital by issuing additional stock, it extends to its stockholders the privilege of subscribing to the new stock, in proportion to their individual holdings, at a price fixed below the market value of the outstanding stock. This privilege of subscribing, technically known as a 'stock right', is evidenced by a formal document or 'warrant', which in appearance resembles a securities certificate.

"Stockholders are permitted to assign or transfer this subscription privilege to others in case they do not care to take advantage of it themselves. Such transfers are made in the open market and as the new stock is offered at less than the market price of the old stock, the rights possess value."

Christy's volume on *The Transfer of Stock* (1929) speaks of subscription rights as follows:

"Sec. 8. *The Creation of Stock Through the Exercise of Subscription Rights.* Stock may be created by allowing the stockholders to subscribe for additional stock to be created by the corporation. In such case, the corporation generally issues subscription warrants which are mailed to stockholders of record on a certain

date. A stockholder wishing to exercise his privilege of subscription presents his warrant, with the subscription price, to the corporation prior to the time when the privilege expires, and the stock called for by the subscription warrant is thereby created. The stockholder may, if he so desires, sell the *rights represented by the warrant,* or he may sell part of them and exercise the balance, and in order that this may be accomplished it is generally provided in the warrant that the warrant may be split up and new warrants aggregating the rights represented by the old warrant issued, upon surrender of the old warrant to the corporation. If the stockholder sells his warrant, the stock will be created in the name of any person presenting the warrant duly endorsed by the registered owner. In such a case the corporation, or its transfer agent, *must see that a stock transfer tax is paid if the law under which the transfer is made imposes such a tax on the transfer of a right to subscribe to stock.*"

Glen G. Munn, *Encyclopedia of Banking and Finance:* New York, the Bankers Publishing Company, 1935, Volume 1, p. 632:

"RIGHTS

"A term to denote the privilege given to a stockholder to subscribe to additional stock of the same or another class or to bonds of the same company, or to convert bonds into stock, at a certain price. Usually the term refers to the privilege accorded a stockholder of subscribing for more stock of the class, at a price below the market, or on such favorable terms as to make the privilege valuable. When a corporation desires to increase its capital stock, it is customary to give its stockholders of record the preference, of subscribing to the additional shares to be issued over the general public, and in amounts proportional to the number of shares already held.

"The privilege attached to one share of stock held of subscribing to the new, regardless of the ratio which the original stock bears to the new, is called one right. The privilege must be exercised within a limited option period, and when the right to subscribe for the new

stock expires, the original stock is said to be "ex-rights."

"*Rights are assignable,* and if the holder of stock with rights does not wish to exercise his rights to purchase new shares, *he may sell and transfer them to another. Each stock exchange deals in the rights which may be attached to* shares traded thereon."

If Congress had intended any broader meaning of the words and phrase employed, it would not have used the word "right" in its plural sense—the phrase would have been formed as follows: "Or to *the right* to subscribe for or to receive such shares or certificates." The use of the plural sense manifestly shows the intent to speak of "rights" as used in corporation parlance where it has a well defined and understood meaning. This is inescapable because the statute requires that there be a "transfer of legal title . . . to rights", and there is not usually an existing legal title to a "right" as otherwise used in its broad, general sense, as contrasted with stock "rights" as used in corporation practice, to which rights there is always legal title by reason of the ownership of and title to shares already issued.

These words were first included in the Revenue Act of 1918 (c. 18, Title XI, 40 Stat. 1057). A search has been made of the reports of the Congressional Committees for an explanation of the meaning intended for the words and phrase in question, but no specific explanation was given. Therefore, the courts are limited to the common and ordinary usage of the words and phrase in ascertaining the intent of Congress.

The report of the Senate Finance Committee on the "Revenue Bill of 1918" (H. R. 12863) was Senate Report No. 617. At page 18, under the heading "Title XI.—Stamp Taxes," it is stated that "no changes of importance were made in this title." The report of the Ways and Means Committee (House Report No. 767) contains the statement that—

"The bill reenacts the stamp tax provision of the revenue act of 1917 without changing the rates except in one instance."

In order to show at a glance the similarity of the provisions of the corresponding provisions of the Revenue Acts of 1917 and 1918 (which latter is identical with the Revenue Act of 1926), the two paragraphs are printed in parallel columns, showing in italics the provisions in one that are not in the other:

1917 Act	*1918* *1926 Acts*
SCHEDULE A.	SCHEDULE A.
4. Capital stock, sales or transfers: On all sales, or agreements to sell, or memoranda of sales, or deliveries of, or transfers of legal title to shares or certificates of stock in any *association, company or* corporation	3. Capital stock, sales or transfers: On all sales, or agreements to sell, or memoranda of sales, or deliveries of, or transfers of legal title to shares or certificates of stock *or of profits or of interest in property or accumulations* in any corporation *or to rights to subscribe for or to receive such shares or certificates.* *

The report of the Commissioner of Internal Revenue, dated October 15, 1919, appended to Annual Report of the Secretary of the Treasury on The State of The Finances for the fiscal year ended June 30, 1919, Washington, 1920, (p. 1103), explaining the changes made in the statute in

question, has only the following statement concerning the changes made:

Revenue Act of 1918

> "The stamp tax provisions of the new law are the same as they were in the 1917 act, except that under the new law * * * issues and transfers of certificates of profits or of interest in property or accumulations in any corporation are taxed the same as issues and transfers of stock; * * *"

Thus, while no explanation was made anywhere of the significance of the addition to the law of the words "rights to subscribe for or to receive", it is plain that the Commissioner of Internal Revenue understood that the words "rights to subscribe for or to receive such shares or certificates" did not materially increase the objects taxed, or he would have mentioned same significantly. This confirms the report of the Senate Finance Committee that "no changes of importance were made in this title."

It is evident from the foregoing columnar comparison that the phrases added to the 1918 Act were inserted to supply the deficiency theretofore existing by reason of the fact that the 1917 Act taxed the sale or transfer of only *shares or certificates of stock;* and that the added words were intended to cover "*certificates* * * * to rights" as commonly known in corporation practice, and "certificates * * * of profits or of interest in property or accumulations," such as "rights", or as stock dividends issued by corporations to existing stockholders, as referred to in *Eisner* v. *Macomber,* 252 U. S. 189, in which case stock dividends were held not income under the Sixteenth Amendment. The significance of this analogy is manifest when it is noted that the above quoted report of the Commissioner is dated October 15, 1919, that *Eisner* v. *Macomber* was first argued April 16, 1919, was on May 19, 1919, restored to the docket for reargument, was reargued October 17 and 20, 1919, and decided March 8, 1920, and that when it became

evident that Congress could not tax "stock dividends", as income, plans were made to tax transfers of "rights" to such dividends. The foregoing conclusion is in consonance with the statement of the Senate Finance Committee that "no changes of importance were made in this title" by the Revenue Act of 1918,—for certainly if "rights" were intended to be used in such broad sense as government counsel contends the Senate Finance Committee would not have belittled the significance of the changes made or described them as unimportant, and the Commissioner would have explained it in his official report.

This meaning of the phrase "rights to subscribe for or to receive" is manifestly the underlying reason why the courts have so uniformly refused to approve the construction of the phrase urged by the government, even though such reason was not expressly stated.

Statutes levying taxes are construed most strongly against the government and in favor of the citizen, and a tax will not be sustained unless liability is clearly established by the language employed in the statute, which must not by implication be extended beyond the clear import of the language used. If there be any doubt it must be resolved in favor of the taxpayer. *Gould* v. *Gould*, 245 U. S. 151; *U. S.* v. *Merriam*, 263 U. S. 179; *Old Colony R. Co.* v. *Com. of Int. Rev.*, 284 U. S. 552, 561-2; *Miller* v. *Standard Nut Margarine Co.*, 284 U. S. 498, 508; *Helvering* v. *Stockholms Enskilda Bank*, 293 U. S. 84, 93.

It is respectfully submitted that the true meaning of the phrase in question, as above shown, must control; and that the phrase was not intended by the legislature to be used in such a broad general sense as applied by the Court in *Raybestos-Manhattan, Inc.* v. *U. S.*, 296 U. S. 60. If Congress had intended such broad general meaning of such an elastic word of speech, it would not have chosen the word so circumscribed as the noun employed [rights].

II

The Rules of Statutory Construction.

Popular, ordinary, commonly accepted meaning which the phrase bears in corporation practice controls, in the absence of the manifestation of a contrary legislative intent:

> *Woolford Realty Co.* v. *Rose*, 286 U. S. 319, 327; *Lang* v. *Com. of Int. Rev.*, 289 U. S. 109, 111; *Reinecke* v. *Smith*, 289 U. S. 172, 174-5; *U. S.* v. *Kirby-Lumber Co.*, 284 U. S. 1, 3; *Miller* v. *Standard Nut Margarine Co.*, 284 U. S. 498, 508; *Old Colony R. Co.* v. *Com. of Int. Rev.*, 284 U. S. 552, 560; *A. Magnano Co.* v. *Hamilton*, 292 U. S. 40, 46-47; *Avery* v. *Commissioner of Int. Rev.*, 292 U. S. 210, 214; *Sproles* v. *Binford*, 286 U. S. 374, 393.

The rule *ejusdem generis*, requiring general words to be assimilated to the particular words, is particularly applicable here. *Helvering* v. *Stockholms Enskilda Bank*, 293 U. S. 88, 89; *Gooch* v. *U. S.*, 297 U. S. 124, 128.

Where legislation on a particular subject [sales and transfers of capital stock] consists of a system of related general provisions indicative of a settled policy, new enactments [the amendment to the Revenue Act of 1918] of a fragmentary nature on that subject are to be taken as intended to fit into the existing system and to be carried into effect conformably to it, unless a different purpose is plainly shown. *United States* v. *Jefferson Electric Co.*, 291 U. S. 386, 396; *U. S.* v. *Arizona*, 295 U. S. 191; *Costanzo* v. *Tillinghast*, 287 U. S. 341, 345.

Words and terms are intended to convey the meaning they have in corporation practice, or in such industry or field where they have a well defined meaning. *Roberts* v. *Tennessee Coal, Iron & R. Co.*, 255 Fed. 469 (C. C. A.), certiorari denied 250 U. S. 659. As the commercial designation and meaning in cases involving import duties: *Arthur* v. *Lahey*, 96 U. S. 112; *Worthington* v. *Abbott*, 124

U. S. 434; *Robertson* v. *Salomon*, 130 U. S. 412; *Pickhardt* v. *Merritt*, 132 U. S. 252; *U. S.* v. *Baruch*, 223 U. S. 191. The language will be presumed to have the same meaning in commerce that it has in ordinary use, unless the contrary is shown. *Sevan* v. *Arthur*, 103 U. S. 597; *Hedden* v. *Richard*, 149 U. S. 346; *Maddock* v. *Magone*, 152 U. S. 368.

CONCLUSION.

It is accordingly submitted that the judgment below should be affirmed, even if it requires a departure from the construction of the statute in *Raybestos-Manhattan, Inc.* v. *U. S.*, 296 U. S. 60.

It is also respectfully suggested that in the *Raybestos* case the Court, while recognizing that the statute requires the transfer of *legal title* to "*rights* * * * to receive," omitted to apply that requirement to the facts involved. The decision holds that the "power to command the disposition of the shares included the right to receive them," but the Court did not find or assume that the two merging corporations had *legal title* to that right. The decision states:

> "We think that this effective disposition of the right to receive the stock involved a taxable transfer quite as much as if the several legal relationships of the parties had been established at different times and by separate documents. It is not doubted that there would have been a taxable transfer if each corporation had conveyed its property to petitioner in exchange for its shares of stock to be issued as the grantor might direct, and had later ordered the certificates to be issued to its stockholders. The reach of a taxing act whose purpose is as obvious as the present is not to be restricted by technical refinements. But we do not discern even a technical difference of any significance between such a transaction and that now before us, where the same duty to issue the stock is created and the same shift of the beneficiaries of it is effected simultaneously in a single document. *No convincing reason is suggested*

why the Act should be thought to tax the one and not the other.'' (Italics ours.)

It is respectfully suggested that in that case the merging corporations never possessed legal title to "rights to receive" the stock of the new corporation, as legal title is known in law, for the reason that legal title to property is created by the contracts and conveyances of men, judgments of courts, and the like, whereas in that case one of the necessary parties to the contract (the new corporation) did not agree that the two merging corporations should ever have the right to its stock.

It is further respectfully suggested that a consideration of the words "legal title" in their commonly accepted meaning demonstrates the merit of the construction of the words "transfers of legal title * * * to rights to subscribe for or to receive such shares or certificates" as contended hereinabove by the *amicus curiae.*

Respectfully submitted,

THADDEUS G. BENTON,
Amicus Curiae.

January, 7, 1937.